Dalton Resources Ltd.

annual report

1998

Corporate Profile

Dalton Resources Ltd. is a junior oil and gas, exploration and production company founded in 1994. Shares of the Company are listed on the Alberta Stock Exchange under the symbol "DAL". Since conception, management has increased the value of the company from $275,000 to a net asset value in excess of $4.0 million. The company produces 100 barrels of oil equivalent per day (boepd) of which 60 percent is gas from 5 major properties and 6 minor properties. In 1998, Dalton's participation in the Strachan prospect helped raise $670,000 in equity and elevated Dalton's share value to $0.45 per share. The Strachan prospect should be on stream by mid 1999 increasing Dalton's production levels to 140-180 boepd (75 percent gas) and subsequently raising cash flow by an equal amount.

This year's Annual General Meeting will take place May 14, 1999 at 2:00 p.m. in the Hamilton Room (+30 level), Bow Valley Square, 205 - 5th Avenue S.W., Calgary, Alberta

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Year 2000 Compliance

Management has evaluated the potential computer problems which could occur due to the year end change from 1999 to 2000. Programs will be implemented to accept this change and will be tested accordingly. We do not anticipate that the year end change will create any substantial problems which will effect our computer systems, nor do we believe it will effect our ability to carry out business in a normal fashion.

1998

President's Message

Dear Shareholders and Investors:

The year of 1998 was a very exciting time for Dalton Resources. In February1998, we started drilling the first exploration well at Strachan. The public interest in the Strachan play created heavy trading activity in the Company's stock, making Dalton the most active stock on the Alberta Stock Exchange for several days during the year. In 1998, Dalton traded 18,813,000 shares for a turnover rate of 84.7 percent of our outstanding shares. This places the trading activity of Dalton in the top 2 percentile of the companies on the Alberta Stock Exchange based on a share volume traded/outstanding shares listed basis. As a shareholder you should now be aware that a new gas discovery was made in both the Swan Hills and the Mannville formations at Strachan. Upon realizing the Swan Hills discovery, Dalton and its partners placed a tight hole status on this project in mid May. This allowed Dalton and our partners time to acquire the bulk of the open crown land along the potential Swan Hills trend. Although the tight hole status imposed in mid May caused concern to our shareholders, management felt it was the best long term solution to solidify our land position. We believe that the deep Swan Hills discovery will be producing gas by mid-year. The shallower Mannville discovery will be producing from a twin well which is scheduled to be drilled after spring break-up. Upon completion and tie-in of both these wells, we anticipate our cashflow to substantially increase.

In regards to our financial statements, Dalton is in an enviable position compared to many other companies of our size. Throughout 1998, we continued to pay down our operating line which at year end stands at $60,000 as compared to $210,000 at year end in 1997.

Dalton traded 18.8 million shares in 1998 for a value of $5.5 million. Dalton's symbol on the Alberta Stock Exchange is "DAL".

Our outstanding crown royalty which was inherited from the December 1995 Piper amalgamation and amounted to $110,000 has been eliminated. Dalton has in excess of $250,000 cash available to complete its share of the tie-in and drilling costs associated with the Strachan project. In October 1998, Dalton commissioned an independent engineering reserves report which incorporated the latest pricing for oil and gas. The December 31, 1998 financial audit incorporated the reserves report and showed that Dalton met the ceiling test criteria, and will not be required to "write down" our petroleum properties as many other companies will be required to do this year. Management believes this is due to conservative reporting of our reserves and capital assets. During 1998, we issued 2.15 million shares in the form of a private placement and exercise of warrants at prices of $0.30 and $0.40 respectfully. The bulk of these funds were used for capital expenditures at Strachan.

During 1999, our primary objective is to have the Strachan project placed on stream. Dalton's production has remained constant in 1998 at approximately 100 barrels of oil equivalent per day (boepd) of which 60 percent is gas. With the tie-in of the two gas wells in Strachan we would anticipate an increase in 1999 of 40 to 80 boepd and will increase our gas to oil mix to 75 percent.

The management of Dalton endeavored in the previous two years to reduce the Corporation's debt to near zero and has taken the approach of raising required capital in the equity markets. These capital issuances are usually done with the hope of minimal dilution. We are debt free and we have the cash available to finalize our tie-in and drilling at Strachan. We will continue to evaluate various opportunities to enhance our value as they arise this year. Dalton is at the threshold of growth and expansion, we would like to thank the continued support of our shareholder base, and look forward to providing you with a quality, value oriented investment.

Sincerely,

Doug Robertson, P. Eng.
President

Dalton produces 100 barrels of oil equivalent per day. We are in an excellent position to grow; we have no debt and a $250,000 cash facility to complete Strachan.

The Strachan Project

Dalton's Newest Area

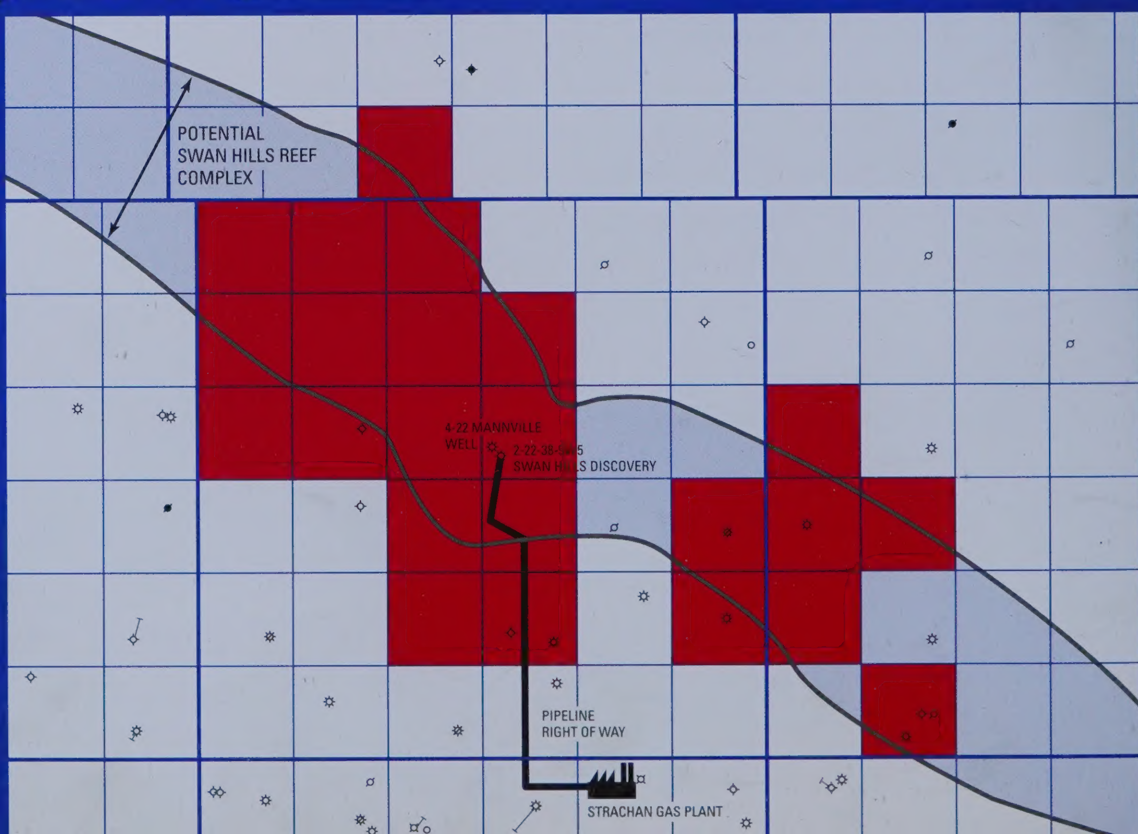
The Strachan project began in late 1997 with Dalton farming into an eight section land package of First Star and Tusk. By February 1998, when the first Strachan well at 2-22-38-9W5 started drilling, the Strachan project had grown to sixteen and one half sections with Apache Canada becoming operator. The primary target was the Leduc (D-3) formation with secondary horizons in the Mannville, Elkton, and Swan Hills. In April, intermediate casing was set below the Elkton formation and a press release was made indicating that gas had been discovered in the Mannville formation. Continued drilling found no reserves in the Leduc formation, but gas was discovered in a dolomitized reef section in the Swan Hills formation. The partners in the well group decided to place a tight hole status on the project upon confirmation of the Swan Hills discovery. The intent of the tight hole status was to acquire, in a meticulous manner, all available open crown P&NG leases which may be along the drilling trend for the Swan Hills. The land acquisition process took until mid September to post and buy the open crown lands. During the tight hole period an initial completion was performed on the Strachan 2-22-38-9W5 well to prove gas production from the Swan Hills. The partners also agreed over the summer months to perform additional acidization work on the Swan Hills which was completed by early September. A public announcement was made regarding the Swan Hills gas discovery on September 18,1998 after the last required crown land sale. The 2-22-38-9W5 Swan Hills well will be tied into the Gulf Midstream Strachan gas plant located four miles to the south. Pipeline routes and AEUB pipeline applications have been made with commencement of construction to start shortly. Initial production rates are expected to be 5-6 million cubic feet per day (mmcfd) of gas from the Swan Hills formation.

A twin well located at 4-22-38-9W5 will be drilled to produce the shallower Mannville discovery. The second well is required since the sour Swan Hills gas cannot be produced in the same well as the sweet Mannville gas. The second location is to commence drilling immediately after spring break-up and will take approximately 30 days to drill. Upon completion, we estimate the Mannville well will produce 3-5 mmcfd plus 10 bbls/mmcf natural gas liquids. We anticipate having both the Swan Hills gas and the Mannville gas producing by July of 1999.

The Strachan prospect will add 400-800 mcfd to Dalton's production by mid 1999. There is also a large land position for future drilling.

Dalton currently holds an interest in 23 sections of land in this area (see map) of which our working interest varies between 7.5-30 percent in all of the deep rights and various shallow rights. Due primarily to the current conditions of the oil and gas business, the joint venture partners of Strachan have decided to farm-out its deep rights to another industry player. We have met with several interested parties concerning this play and are anticipating a seismic/drilling option deal to be completed by the second quarter of 1999. Additional shallow drilling opportunities will arise at Strachan and we will decide on our level of participation based on technical risk and available capital.

STRACHAN AREA



Our reserve mix is approximately 60 percent gas and 40 percent oil. Upon commencement of the Strachan production, Dalton will produce 75 percent gas.

Operations Review

During 1998, Dalton sales volumes averaged 97 boepd, consisting of 557 mcfd and 41 bopd. Various field improvements occurred during the year at Cheddarville and Mulligan where solution gas was tied-in and Meekwap where additional drilling occured. These improvements maintained our production levels which offset natural decline rates. Dalton's primary gas producing properties are located at Jenner, Nevis, Cheddarville, T'sea, and primary oil producing properties are the Meekwap D2-A Unit, Cheddarville, Nevis, and Mulligan. The Company does not produce any medium-heavy or heavy oil. Management has analyzed these potential targets as non-value adding at this time. Dalton's core investment targets are gas and light oil products.

During the year, Dalton continued to rationalize its minor properties to reduce our administration burden and capitalize on high prices. To accomodate this, we sold our interest in two properties which netted Dalton 3 bopd for $192,800.

Capital expenditures in 1998 were funded through two equity issuances which occurred in 1998, an equity issuance in 1997 and existing cash flow.

Total Capital Expenditures for 1998 net to Dalton were as follows:

Cheddarville solution gas tie-in	$ 7,300
Meekwap D2-A Unit drilling and tie-in	34,700
Mulligan solution gas tie-in	18,200
Strachan drilling completion and land acquisition	1,108,000
TOTAL CAPITAL EXPENDITURES	**$ 1,168,200**

We anticipate that by mid 1999, Dalton will have both the deep Swan Hills reserves and the shallow Mannville reserves on stream at Strachan. The new gas production will add 40-80 boepd to Dalton's existing production and provide a significant boost to our current cash flow.

AUDITOR'S REPORT

We have audited the consolidated balance sheets of Dalton Resources Ltd. as at December 31, 1998 and 1997 and the consolidated statements of operations and deficit and changes in financial position for the year ended December 31, 1998, the five month period ended December 31, 1997 and the year ended July 31, 1997. Theses financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the year ended December 31, 1998, the five month period ended December 31, 1997 and the year ended July 31, 1997 in accordance with generally accepted accounting principles.

PricewaterhouseCoopers LLP

Pricewaterhouse Coopers
Chartered Accounts

CONSOLIDATED
BALANCE SHEET

As at	December 31 1998	December 31 1997
Assets		
Current assets		
Cash	**$ 41,440**	$ –
Temporary investments	**264,919**	7,489
Accounts receivable	**197,714**	297,022
Notes receivable (Note 2)	**–**	591,540
Prepaids and deposits	**43,333**	35,713
	547,406	931,764
Capital assets (Note 3)	**$ 3,078,114**	$ 2,475,940
	$ 3,625,520	$ 3,407,704
Liabilities		
Current liabilities		
Cheques issued in excess of bank balance	**$ –**	$ 9,049
Operating loan (Note 4)	**60,000**	210,000
Accounts payable and accrued liabilities	**204,476**	172,260
Income taxes payable	**7,000**	7,592
	271,476	398,901
Provision for future site restoration costs	**49,974**	49,019
Non-controlling interest	**121,933**	131,152
Deferred taxes	**30,014**	30,014
Shareholders' Equity		
Share capital (Note 5)	**3,742,735**	3,342,895
Deficit	**(590,612)**	(544,277)
	3,152,123	2,798,618
	$ 3,625,520	$ 3,407,704

Approved by the Board:

Kevin Flaherty, Director

Doug Robertson, Director

Consolidated Statement of Operations and Deficit

	Year ended Dec., 31, 1998	Five month period ended Dec. 31, 1997	Year ended July 31, 1997
Revenue			(Note 9)
Petroleum and natural gas sales	**$ 586,780**	$ 262,719	$ 792,320
Royalties paid, net of Alberta Royalty Tax Credit	**(53,540)**	(28,005)	(94,288)
	533,240	234,714	698,032
Interest and other	**19,670**	18,640	37,644
Processing fee	**97,402**	51,870	84,598
	650,312	305,224	820,274
Expenses			
Operating	**203,924**	82,400	262,408
General and administrative	**252,494**	101,134	263,799
Depreciation, depletion and amortization	**206,958**	117,671	481,326
Provision for loss on temporary investments	**1,957**	16,944	–
	665,333	318,149	1,007,533
Loss before the following	**(15,021)**	(12,925)	(187,259)
Income taxes			
Current	**7,000**	–	11,556
Deferred	**–**	–	3,890
	7,000	–	15,446
Non-controlling interest in net income of subsidiary	**24,314**	15,966	4,930
Loss for the period	**(46,335)**	(28,891)	(207,635)
Deficit, beginning of period	**544,277**	515,386	307,751
Deficit, end of period	**$ 590,612**	$ 544,277	$ 515,386
Loss per share	**$ –**	$ –	$ 0.01

Consolidated Statement of Changes in Financial Position

	Year ended Dec., 31, 1998	Five month period ended Dec. 31, 1997	Year ended July 31, 1997
Cash was provided by (used for)			(Note 9)
Operating activities			
Loss for the period	**$ (46,335)**	$ (28,891)	$ (207,635)
Add (deduct): Items not affecting cash			
Depreciation, depletion and amortization	**206,958**	117,671	481,326
Non-controlling interest	**24,314**	15,966	4,930
Gain on sale of temporary investments	**–**	–	(11,377)
Deferred income taxes	**–**	–	3,890
Provision for loss on investments	**1,957**	16,944	–
Dividend paid to minority interest	**(33,533)**	–	(31,085)
	153,361	121,690	240,049
Changes in non-cash working capital items	**123,852**	(108,993)	(75,731)
	277,213	12,697	164,318
Financing activities			
Share capital issued, net of expenses	**399,840**	75,000	510,000
(Repayment) advances of operating loan	**(150,000)**	(60,000)	150,000
Notes receivable	**591,000**	–	(580,000)
	840,840	15,000	80,000
Investing activities			
Additions to petroleum and natural gas properties	**(999,566)**	(36,428)	(277,302)
Additions to mining properties	**–**	–	(27,442)
Additions to capital assets	**(1,488)**	(495)	(1,200)
Proceeds on sale of petroleum and natural gas properties	**192,878**	5,309	37,457
Temporary investments	**(259,388)**	–	131,845
	(1,067,564)	(31,614)	(136,642)
Increase (decrease) in cash	**50,489**	(3,917)	107,676
Cheques issued in excess of bank balance beginning of period	**(9,049)**	(5,132)	(112,808)
Cash (cheques issued in excess of bank balance) end of period	**$ 41,440**	$ (9,049)	$ (5,132)

Note 1

Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the Company and its 50% subsidiary McDrake Investments Ltd.

PETROLEUM AND NATURAL GAS PROPERTIES AND RELATED TANGIBLE EQUIPMENT

The Company follows the full cost method of accounting for oil and gas expenditures. Capitalized costs include land acquisition, geological and geophysical expenses and costs of drilling both productive and non-productive wells. Capitalized costs including tangible equipment are depleted by the unit-of production method based on the Company's share of gross proven reserves of oil and gas as determined by independent reserve engineers, with products being converted to a common unit of measure based on relative energy content. Petroleum and natural gas properties are subject to a ceiling test under which their carrying value is limited to the future net revenue (undiscounted) form production of estimated proven reserves, based on year end prices, plus the unimpaired costs of non-producing properties less estimated future administration costs and income taxes.

FLOW-THROUGH SHARES

The resource expenditure deductions for income tax purposes (related to exploration and development activities funded by flow-through share arrangements) are renounced to investors in accordance with income tax legislation. petroleum and natural gas properties and share capital are reduced by the estimated costs of the renounced tax deductions when the expenditures are incurred.

OTHER CAPITAL ASSETS

Other capital assets are recorded at cost. Depreciation is provided for on the following basis and rates:

Office equipment	20% declining balance
Processing facilities	straight-line over 20 years

EARNINGS PER SHARE

Earnings per share are calculated on the basis of the weighted average number of common shares outstanding during the respective fiscal years. Fully diluted earnings per share are antidilutive and therefore are not disclosed.

FUTURE SITE RESTORATION

Estimated future removal and site restoration costs, net of expected recoveries, are provided for over the life of the proven reserves on a unit-of-production basis and included in depreciation, depletion and amortization provisions. Costs are estimated each year by management based on current regulations, costs, technology and industry standards. Removal and site restoration expenditures are charged to the accumulated provision account as incurred.

Note 2

Notes Receivable

Notes receivable consisted of a note receivable and accrued interest of $64,102 and a promissory note receivable and accrued interest of $527,438 from directors of the Company, bearing interest at prime plus 2% per annum and prime plus 1% respectively. In February 1998, these items were paid in full.

Note 3

Capital Assets

DECEMBER 31, 1998	Cost	Accumulated Depreciation	Net
Petroleum and natural gas properties	$ 3,063,273	$ 641,429	$ 2,421,844
Equipment	483,247	104,163	379,084
Processing facilities	336,260	59,074	277,186
	$ 3,882,780	$ 804,666	$ 3,078,114
DECEMBER 31, 1997			
Petroleum and natural gas properties	$ 2,280,703	$ 459,152	$ 1,821,551
Equipment	491,999	100,986	391,013
Processing facilities	301,902	38,526	263,376
	$ 3,074,604	$ 598,664	$ 2,475,940

The Company capitalized $50,000 (1997 - $4,875) of general and administrative costs during 1998.

Note 4

Operating Loan

The operating loan consists of a demand direct revolving reducing loan to a maximum of $160,000 (1997-$300,000) and bearing interest at prime plus 1% per annum. The loan is secured by a $400,000 floating charge debenture on all the assets of the corporation.

Note 5

Share Capital

AUTHORIZED

Unlimited number of Common Voting Shares without nominal or par value
Unlimited number of First Preferred Shares
Unlimited number of Second Preferred Shares

The First and Second Preferred Shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

ISSUED COMMON SHARES	Year ended December 31, 1998		Five months ended December 31, 1997	
	Number of Shares Issued	Amount	Number of Shares Issued	Amount
Beginning of period	20,118,110	$ 3,342,895	19,868,110	$ 3,267,895
Exercise of stock options	60,000	13,800	250,000	75,000
Private placements	1,686,668	506,000	–	–
Exercise of warrants	404,500	161,800	–	–
Tax benefits renounced to shareholders	–	(209,760)	–	–
Share issue costs	–	(72,000)	–	–
End of period	22,269,278	$ 3,742,735	20,118,110	$ 3,342,895

In 1998, the Company entered into a Private Placement for the issuance of 1,520,001 flow-through shares and 166,667 Common Shares at a price of $0.30 per share.

In the period ended December 31, 1998, the Company issued and had outstanding 843,334 warrants exercisable at $0.40 per share expiring May 31, 1999, pursuant to a Private Placement. During the period ended December 31,1998, a total of 2,345,500 previously issued warrants exercisable at $0.40 expired as at May 5, 1998.

STOCK OPTIONS

The Company has a share option plan under which its board of directors may allocate nonassignable options to purchase common shares of the Company to directors, officers, consultants and agents. The number of options outstanding has varied as follows:

	December 31, 1998	December 31, 1997
Balance at beginning of year	1,998,571	1,833,571
Granted	–	415,000
Exercised	(60,000)	(250,000)
Balanced at end of year	1,938,571	1,998,571

At December 31, 1998, there were 1,938,571 options outstanding to purchase common shares for consideration ranging from $0.17 to $0.35 per share, expiring at various dates to December 15, 2002.

Note 6

Income Taxes

For income tax purposes, the Company has losses carried forward from prior years which can be used to reduce future years' taxable income. in addition, the Company has tax pool balances in excess of the net book value of the Company's assets. The potential benefit relating to theses available losses and additional unclaimed costs totalling $1,480,000 has not been recorded in the financial statements.

Note 7

Financial Instruments

(a) Credit risk

The Company's financial assets are concentrated with counter parties involved in the oil and gas industry in Western Canada.

(b) Interest rate risk

At December 31, 1998 the increase or decrease in net earnings for each one percent charge in interest rates on floating rate financial instruments would not be material.

(c) Fair values

The fair values of the Company's financial instruments do not differ significantly from their carrying values.

Note 8

Uncertainty Due To The Year 2000 Issue

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 19000 or some other date resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other that a date. The effects of the Year 2000 issued may be experienced before, on, or after January 1, 2000, and , if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

Note 9

Comparative Figures

Certain comparative figures have been restated to conform with the current year's financial statement presentation.

Corporate Information

OFFICERS AND DIRECTORS

Doug Robertson, P. Eng.
Chief Executive Officer and Director
Millarville, Alberta, Canada

Kevin Flaherty, MBA
Chief Financial Officer and Director
Calgary, Alberta, Canada

Stuart McColl, Geol. Eng.
Director
London, England

Wayne O'Connor, B. Comm.
Director
Calgary, Alberta, Canada

Dennis Bleackley, C.A.
Director
Calgary, Alberta, Canada

EXCHANGE
Alberta Stock Exchange (ASE)
Trading Symbol: **DAL**

SHARE CAPITAL
Issued and outstanding: 22,269,278
Warrants at $0.40: 843,334
Expire: May 31, 1999

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Montreal Trust
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